

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: Interview of Clay Bingham on April 19, 2006

DATED: July 6, 2006

On April 19, 2006, Michael Schachter and Michael Shapiro, in Willkie Farr & Gallagher LLP's capacity as counsel to the Audit Committee, interviewed Clay Bingham at the City Administration Building, 202 C Street, in San Diego, in a conference room on the third floor. Johnny Giang and Tammie Davis from KPMG also attended the interview. Mr. Bingham was not represented by counsel.

The following memorandum reflects my thoughts, impressions, and opinions regarding our meeting with Clay Bingham, and constitutes protected attorney work product. It is not, nor is it intended to be, a substantially verbatim record of the interview.

Warnings

Mr. Schachter informed Mr. Bingham that we are counsel to the Audit Committee and do not represent him or any employee. He advised Mr. Bingham that the interview may be considered attorney work product and confidential, but the decision of whether to keep it confidential will be made by the Audit Committee in the best interests of the City, not by Mr. Bingham personally. Mr. Schachter said we will create a report which may contain statements of interviewees, and this report will likely be provided to KPMG and ultimately made public. He said government agencies may view the report and be provided with additional information so it is important to be truthful and accurate.

Background

Mr. Schachter asked Mr. Bingham to describe his professional background. Mr. Bingham said he has worked for the City for thirty years, beginning as a Budget Analyst in the late 1970's. From 1975 to 1980, he worked in the Department of Transportation, then the Financial Management Department, and then the City Council's Office. Mr. Bingham became a Supervising Analyst in the Police Department, where he worked from 1980 to 1990. In 1990, Pat Frazier (Deputy City Manager) asked him to become part of the Clean Water Program, a division of the Water Department. It soon became its own department, the Metropolitan Wastewater Department ("MWWD"). He served as Supervising Management Analyst and worked on budgeting for 10 years for the MWWD. His staff coordinated budgeting for Operations & Maintenance as well as for Capital Improvement Projects ("CIP"), and also worked on documentation for the rate cases. In 2000, he was provided an additional duty, Manager of the Community Services Center at Scripps Ranch, which he performed until 2005.

In 2005, he was promoted to Deputy Director of Parks and Recreation, a position in which he manages maintenance of the District Assessment Program and which he still holds.

Mr. Schachter asked Mr. Bingham to describe his reporting structure. He said that from 1994 to 2004, he reported to Bill Hanley (Deputy Director for Contract Services, MWWD). Prior to 1994, he reported to Chuck Mueller (Financing Services Manager). He had approximately 14 direct reports, including Ron Villa (Director of Financial Management).

Wastewater

Cost of Service Study

Mr. Schachter asked Mr. Bingham to describe his involvement with the Cost of Service Study ("COS"). He responded that the COS was managed by Financing Services. Mr. Bingham provided documentation regarding CIP and Operations and Maintenance to the COS outside consultants, Montgomery Watson. Montgomery Watson reviewed the City's capital program and would arrive at a definition of a capital project - - what percentage of cost was based on flow, SS (suspended solids) and BOD/COD (biological oxygen demand/chemical oxygen demand; *i.e.*, organics). Montgomery Watson would use that information and a customer base analysis to derive a relationship and allocate costs fairly. Hanley was the liaison between the MWWD and Dennis Kahlie and Eric Adachi of Financing Services regarding the COS. David Schlesinger, Director of MWWD, would frequently ask Hanley about the progress and implementation of the COS. Mr. Bingham stated that he heard that people "downtown" were not happy with the COS consultants and their recommendations.

Mr. Schachter asked Mr. Bingham to discuss why the COS was not implemented in a timely fashion. Mr. Bingham responded that internally it was known that the move to BOD would impact restaurants and Kelco and that it was a political issue. He did not know who was resistant to changing the user rates. Mr. Bingham heard gossip that Mayor Golding was reluctant to change the rates because she was considering seeking higher office and Kelco and the restaurants were supporters of and political contributors to her campaign. He also heard gossip that rate setting was a political issue and by 1998, people were sensitive about it and aware of the impact it would have on ratepayers. He remembered frustration on the part of Kahlie and others as to why the user rates had not been changed and the COS had not been implemented. The reasons for not implementing a new system were not shared with Mr. Bingham or his staff. He suspected that Mayor Golding and Mayor Murphy were reluctant to change the rates.

Mr. Bingham was shown Exhibit 1, a June 1, 2001 email from Hanley to Kahlie, Adachi, Bingham, Scott Edwards, and Scott Tulloch (Director of MWWD) re: "Fwd: May 15th Budget Referrals." When asked by Mr. Schachter if he recalled the e-mail, Mr. Bingham said he did not. Mr. Schachter asked Mr. Bingham if he recalled the 1998 COS and if he recalled any other COS. He responded that he remembered the 1998 COS but did not recall the others. Mr. Schachter asked Mr. Bingham if he was aware of efforts to get the City into compliance and that Kahlie told the City Council of the City's noncompliance with the State's requirements. Mr. Bingham responded that he was aware of continuing efforts to get the COS implemented. He said he was aware that Kahlie told the City Council of noncompliance with the State's requirements and the fact that \$370 million in grants/loans could be recalled.

Mr. Schachter asked Mr. Bingham about the status of the COS and implementation of the rate structure in 2004. Mr. Bingham responded that by 2004, there was a feeling that the City was "getting to the end of the line" and had to get into compliance with the State's requirements by adding COD to the user rates. Kelco was still attempting to forestall such implementation and proposed an alternative method to implement COD.

Status of the 2003 POS

Mr. Schachter asked Mr. Bingham to discuss his knowledge of the status of the 2003 sewer bond offering. Mr. Bingham stated that he was involved in the sewer bond offerings from 1993 to 2003. The 2003 sewer bond Preliminary Official Statement ("POS") was never publicly issued. It was ready for issuance in New York but he heard that bond counsel, Orrick Herrington, had concerns regarding pension disclosures because of a comment made by Diann Shipione (SDCERS Board Trustee). The sale did not take place at all but he believed a final Official Statement ("OS") was issued.

Awareness of Noncompliance

Mr. Schachter asked Mr. Bingham when he first became aware that it was a State requirement to bill City users based on organics. Mr. Bingham said that by 1997, he and others understood that to comply with State requirements, the City had to include organics in their billing for City users. The plan was to move to strength-based billing ("SBB") for City users by fiscal year 1999.

Mr. Schachter asked Mr. Bingham about his knowledge of the State's requirements and the City's implementation of those requirements by 1999. Mr. Bingham said that by 1999, he and others knew that they had to go to SBB and had not yet received a "drop dead date" from the State to do so. There was discussion concerning when the drop-dead date would occur. Mr. Schachter asked Mr. Bingham if he was aware of those repercussions. Mr. Bingham responded that he was aware of the repercussions of noncompliance, including loan acceleration; however, he noted that the City was not "being hammered" for not moving forward yet. Mr. Schachter asked Mr. Bingham if he knew that COD was a legal requirement. Mr. Bingham responded that he did not realize COD was a legal requirement but knew it was a State requirement for grants and loans.

Mr. Schachter asked Mr. Bingham if Ron Blair (Revenue Program Specialist for the State Water Resources Control Board) was aware of the City's noncompliance. He responded that he was told that Richard Enriquez (Grants Administrator for MWWD) and Mick Gammon (Supervising Management Analyst for MWWD) had discussions with Blair in which Blair expressed that he wanted the City to move to SBB but did not demand compliance by a certain date. Mr. Bingham had the impression that the State wanted the City to get into compliance but was not ready to give the City "the hammer" yet. He said that this leniency provided room for the politicians in the City to deal with the issue. Frustration grew in 2003, and Kahlie demanded that the rates be changed.

Disclosure of Noncompliance and the POS

Mr. Bingham was shown Exhibit 2 a September 17, 1999 memo from Hanley to Kahlie re: "SRF Loan Document Issues." Mr. Schachter asked Mr. Bingham why Hanley did not mention noncompliance in the memo. He responded that he did not know.

Mr. Bingham was shown Exhibit 3, a December 2, 1998 list of "Required Items for the Wastewater System Preliminary Official Statement (Sorted by Responsible Party)." Mr. Schachter asked Mr. Bingham to describe how a POS was prepared. Mr. Bingham responded that preparation for a POS (and eventually the OS) was a team effort involving regular meetings. Such meetings involved bond counsel and financial advisors. Typically in attendance would be Bingham or Hanley; Ted Bromfield or Kelly Salt from the City Attorney's Office; Ed Ryan or Ed Wochaski from the City Auditor's Office; the Financial Advisor Montague & DeRose; Adachi, Kahlie and sometimes Frazier from Financing Services; and Paul Webber and Jenna Magan from Orrick. At these meetings, everyone received assignments. Mr. Bingham was responsible for updating the introduction regarding the wastewater system and the sections about the components of the system. He coordinated some of the tables including the two regarding the Participating Agencies ("PA's"). The City Attorney's Office dealt with the sections concerning court cases, litigation and pension discussions. At the meetings, also referred to as "page turners," Webber would go page by page through the disclosure for hours. Webber would ask questions about each page.

Mr. Schachter asked Mr. Bingham whether any discussion took place at the POS page-turners concerning noncompliance with the State requirements. Mr. Bingham responded that he did not recall a discussion at the page turners regarding noncompliance. Mr. Schachter asked Mr. Bingham to comment on the "disallowed" language in the POS. Mr. Bingham responded that he now thinks the "disallowed" language in the POS is "cute," but did not recall reviewing the language at the time of the offering.

Mr. Schachter asked Mr. Bingham whether Webber was aware of the City's noncompliance with the State's requirements. Mr. Bingham responded that Webber knew the City was not in compliance with sewer user rates. When questioned about his knowledge of Webber's awareness, he said that Webber attended meetings where the POS was discussed and he believed SBB was discussed during these meetings. He did not recall hearing Webber being told about the City's noncompliance.

Mr. Schachter asked Mr. Bingham why he did not raise the issue of noncompliance during the POS page-turners. He responded that he was not invited to participate in discussions regarding sewer disclosures. Mr. Bingham stated that he was worried about the questions he would be asked about the sections he was responsible for and not about other sections. He said he was not competent to question others on their sections. He believed that the discussion regarding disclosure would occur at a high level, above his rank. Mr. Bingham stated that disclosure issues were "closely held" and that they would not have been discussed in front of him, but rather in front of Deputy City Manager George Loveland and Frazier.

Mr. Schachter asked Mr. Bingham whether he felt Webber was pro or anti-disclosure. Mr. Bingham responded that he never felt that Webber was reluctant to disclose. He recalled discussions during the POS meetings where people would express reluctance to disclose

items because of their impact on things like the EPA waiver. He volunteered that "lots of folks" were upset with Webber. He participated in discussions concerning Webber's knowledge of the State's requirements and noncompliance, after the voluntary disclosure occurred. Mr. Schachter asked Mr. Bingham whether Salt was reluctant to disclose. He responded that he did not recall Salt being reluctant to disclose but noted that everyone wanted the City "to look good."

Mr. Bingham added that he had not thought about the disclosure issues regarding the noncompliance with the State's requirements before today. He said that the lack of disclosure was a product of compartmentalized decision making and a hierarchical structure, which he believed led to all of the City's current problems.

Disclosure to Rating Agencies

Mr. Bingham was shown Exhibit 4, a June 19, 2003 email from Darlene DeRose to Kahlie, Adachi, John Costagliola, Tom Innis, Hanley, Bingham and Wochaski re: "Ratings Presentation" and attaching "the most recent version of the ratings presentation." Mr. Schachter asked Mr. Bingham if he knew who prepared the various pages of the presentation. Mr. Bingham said he drafted page 19 of this presentation and that Tulloch drafted page 17. Adachi prepared page 35. Mr. Schachter asked Mr. Bingham if he reviewed the entire presentation. Mr. Bingham said he reviewed the entire presentation but did not consider the issue of noncompliance with the State's requirements.

Mr. Bingham was shown Exhibit 5, a June 30, 2003 email from Hanley to Kahlie, Adachi and Bingham re: "Fwd: FITCH's Follow-up Questions." Mr. Schachter asked if Mr. Bingham was involved in responding to Fitch's questions. Mr. Bingham said he was not involved in responding to Fitch's questions and did not recall Fitch asking about the rate structure.

Mr. Bingham was shown Exhibit 6, a July 1, 2003 email from Kahlie to Bromfield, Adachi, Bingham and Hanley re: "Proposed Responses to Fitch's Questions." Mr. Schachter asked Mr. Bingham why he received this email. Mr. Bingham responded that he did not recall reviewing it and was provided it as an "FYI" because he was part of the process. He did not recall discussions about it. Mr. Schachter asked Mr. Bingham if he would have changed the language in item number 3 ("The Board has periodically provided input to MWWD concerning its rate structure and changes thereto, but has never disapproved the structure or any component thereof.") if he could have. Mr. Bingham responded that if it were up to him, item number 3 would have caused him concern but he did not recall having any concern at the time. Mr. Schachter asked Mr. Bingham if he reviewed the SRF loan agreements. He said he did not review SRF loan agreements but noted that Gammon and Enriquez did so.

Stakeholders' Group

Mr. Schachter asked Mr. Bingham to describe the Stakeholders' Group. Mr. Bingham said that the Stakeholders' Group was composed of ratepayers impacted by BOD/COD. At the Stakeholders' meetings, Doug Sain represented Kelco. Kelco and the restaurants were most impacted by inclusion of BOD/COD in the billing.

Kelco

Mr. Bingham was shown Exhibit 7, an October 26, 1998 letter from David Schlesinger (Director of MWWD) to Stephen Zapotichny (Director, Environment, Safety and Health for Monsanto Company) re: "Cost of Services Study for Municipal Wastewater Services." Mr. Schachter asked Mr. Bingham why Schlesinger sent this letter to Zapotichny. Mr. Bingham responded that he believed Schlesinger informed Kelco of the COS to let them know it would impact them.

Mr. Bingham was shown Exhibit 8, a November 12, 1998 email from Hanley to Loveland, Schlesinger and Susan Hamilton (MWWD), ccing Phil Moffitt (Financing Services), Hedy Griffiths (Supervising Management Analyst, Agency Contracts, MWWD), Bingham, Bromfield, and others re: "Meeting with Kelco – Strength Based Billing." Mr. Schachter asked Mr. Bingham whether he attended the meeting and why the document was marked "business sensitive." Mr. Bingham responded that he did not attend the meeting and had never seen a document marked "business sensitive." He heard of meetings with Kelco but was not briefed on them. Mr. Schachter asked Mr. Bingham if he heard that Loveland was supportive of Kelco; Mr. Bingham said he did not. Mr. Schachter asked Mr. Bingham if he heard that Kelco was behind the delay in implementing the COS. He responded that he heard background comments that Kelco caused delays and that the City was "bending to Kelco," but no one in a position of knowledge said such a thing to him.

Mr. Bingham was shown Exhibit 9, a March 26, 1998 memo from Lynn Phelps to Distribution List re: "Notes from meeting on COD Requirements of March 18, 1998." When asked by Mr. Schachter if he recalled the meeting, Mr. Bingham said he did not recall this meeting but that such meetings took place. Mr. Bingham was shown Exhibit 10, a February 17, 2005 email from Enriquez to Bingham and Gammon re: "Fwd: EPA/SWRCB Revenue Program Background Information." Mr. Bingham said that Gil Wheeler was a consultant who worked closely with Enriquez on issues involving the SWRCB and grants/loans.

Pension

Mr. Bingham was shown Exhibit 11, a September 10, 2003 email from Hanley to Kahlie, Adachi, Wochaski, and Bingham re: "Post Retirement Health Insurance/POS Table 14." Mr. Schachter asked Mr. Bingham why he received this email. Mr. Bingham said he did not recall the issue and that everything was on a "need to know" basis.

Conclusion

Mr. Schachter asked Mr. Bingham if he knew or was aware of any illegal, improper, or unethical conduct on the part of any city employee. Mr. Bingham said he did not know of any illegal, improper or unethical conduct on the part of any city employee. Mr. Schachter requested that Mr. Bingham keep the interview confidential to preserve the integrity of the process. Mr. Schachter informed Mr. Bingham that if he recalled any information or wished to inform us of any new information, he should contact us.

WF&G